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Naftogaz reforms in danger

UkraineAlert by Diane Francis

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Naftogaz CEO Andriy Kobolyev says reforms at the Ukrainian energy giant are under attack. (REUTERS/Valentyn Ogirenko)

Energy giant Naftogaz is the corporate governance poster child among Ukraine's many state-owned enterprises. Since 2014, it has transitioned from fraud-riddled drain on government finances to a profitable business model complete with good governance. Along the way, Naftogaz also extricated itself from the Russian and Ukrainian oligarchs who used it to enrich themselves, and signed an important gas transit contract with Gazprom after winning billions of dollars in court from the Russian company.

"Naftogaz is a clean corporation. We have cleaned up corruption," says Naftogaz CEO Andriy Kobolyev. "Five years ago, the Naftogaz deficit was USD 6.5 billion, which came out of the Ukrainian budget. Our contribution now represents 20 percent of total government revenues. We set up an independent Supervisory Board to undertake corporate governance reform, which is what the IMF, EBRD, and OECD asked for. We are audited by Deloitte and KPMG."

Despite these stellar achievements, or perhaps because of them, Naftogaz is now a major target. Along with the country's other anti-corruption success stories, it is coming under pressure from malevolent forces intent on recapturing state enterprises and turning back the clock.

In recent months, attempts by Ukrainian judges, government officials, and politicians to unravel reforms and harass reformers have captured headlines. Kobolyev says he is also personally coming under attack. "There have been bribery attempts and some direct threats. There are a number of cases currently with the police and a couple of ongoing investigations. I also have extensive security."

One recent challenge came via the State Audit Service of Ukraine, which alleged the company was guilty of "high treason" for accounting irregularities, even though Naftogaz has an independent Supervisory Board and meets international

auditing standards. The scurrilous allegations made bond investors nervous and forced the company to cancel two major bond offerings planned for this year.

Then, in early October, Amos Hochstein, a ranking member of Naftogaz’s independent Supervisory Board, quit after an attempt was made to shoehorn a director onto the Board who had worked for the corrupt Yanukovich regime. Hochstein **explained** his resignation and issued a warning about ongoing interference. “Unfortunately, Naftogaz management’s successful efforts to create a new corporate culture, transparent mechanisms, and adherence to international standards, were resisted at every step of the way. The company has been forced to spend endless amounts of time combating political pressure and efforts by oligarchs to enrich themselves through questionable transactions,” he wrote. “The sooner the government of Ukraine internalizes this fact, the stronger Ukraine will be. Failing to do so will imperil Ukraine’s quest to build a strong, democratic, and free country.”

Despite these concerns, Kobolyev says much was accomplished during the first year of cooperation with President Zelenskyy’s government. “First came unbundling. Then we signed a huge deal with Gazprom for USD 7.2 billion, and managed to collect all the money they owed to us. This August, the government did what Naftogaz has been fighting to achieve for five years, by removing certification [to intermediaries controlled by exiled gas oligarch Dmytro Firtash] that made households free to choose their energy supplier. This was a big step forward and the government should be given due credit.”

“On the negative side is the departure of Hochstein and attacks on our corporate governance system. This is very negative and is playing out now. It affects the company in a big way and leaked into the press right before our Eurobond issue. Our investors withdrew their commitment to buy bonds the same day. Another report [by the State Audit Service] claiming Naftogaz should pay more dividends was also damaging. This is not something critical for us in terms of financing our debt portfolio, but it’s very negative,” he says.

WED, DEC 2, 2020

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12:00PM

Kobolyev hopes the new US administration will continue supporting Ukrainian reform efforts, and suggests Kyiv double-down on reforms by removing all state control that is no longer necessary, while ignoring politically-motivated criticism. “The government should allow [Naftogaz’s] existing Supervisory Board members to find a replacement for Hochstein, then propose that replacement to the shareholder [the government] for final approval,” he says. “That is the most appropriate and most rational approach. Not only Hochstein has left, but two more independent members’ terms will expire in December. There is no indication from the government regarding what it wants. It must make clear to Supervisory Board members that their contracts are extended.”

The Naftogaz CEO believes recent attacks against the company are due to “political pressure from people like Firtash” who lost his stranglehold on domestic gas distribution in August. Kobolyev also accuses Ukrainian politicians including Yulia Tymoshenko and Viktor Medvedchuk, who oppose the unbundling process, of being Kremlin proxies “following the Russian narrative”. “If unbundling is considered illegal, then Gazprom will be free not to honor their obligation under the transit contract signed in December 2019,” he points out. “They don’t bother themselves with complex arguments on behalf of Ukraine.”

Looking ahead, Kobolyev says the long-term objective remains to privatize Naftogaz. “We have offered this to the government and the PM has agreed that Naftogaz should become a publicly-listed company within three years. We are preparing to do that. We are working on this every day. We would like to list on the New York Stock Exchange and we already meet the audit and corporate governance requirements,” he says.

Kobolyev was recently in Washington to meet with Congressional leaders from both parties who support anti-corruption efforts in Ukraine as well as sanctions to halt Russia’s Nord Stream 2 gas pipeline project. Tougher sanctions have been proposed and are included in the upcoming US defense budget. If adopted, they are expected to permanently halt construction of the incomplete pipeline.

“We haven’t won yet. The Russians have redesigned one of their own ships and are trying to get construction back on track. In order to stop them, there should be improved wording in the proposed sanctions law,” he says. “This wording is critically important to block the pipeline. So far, we are 95 percent towards stopping Nord Stream 2. We need the last five percent to insure the project is finally dead.”

Kobolyev hopes the new US administration will continue to support Ukraine, including backing for gas market reform and corporate governance reform. When asked how optimistic he is about the future of Naftogaz, he hedges. “I’m not ready to give such an assessment. It would just be a wild guess. But if I was not optimistic, I would have already resigned.”

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